RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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July 21, DJIA 833.42; PTI 827; A-D Ratio –18.91

ACTION: It's clear to me what happened. The Arabs looked at the Bonn "summit" conference. They couldn't find anything taking place that was worth a plugged nickel. Then they heard Carter blather about how constructive it all was. A few days later the Arabs (OPEC) announced that they were recommending to their Committee that oil would be valued on a basket of currencies basis rather than the dollar. Europe is already making plans to pull away from the dollar. Meanwhile, the Fed is following a relaxed credit posture. The great US monetary tragedy continues to unfold.

WOULD THEY? Is this it? Would they do it? Would they just let the money supply boom, let the dollar go, let it all slide (and after Carter's widely-touted meeting at Bonn)? I look at my charts of gold, the Deutschemark, the Yen and the Swiss franc, all of them in uptrends and ready to break out to new highs–and my only conclusion is yes, THEY COULD JUST LET IT RUN!

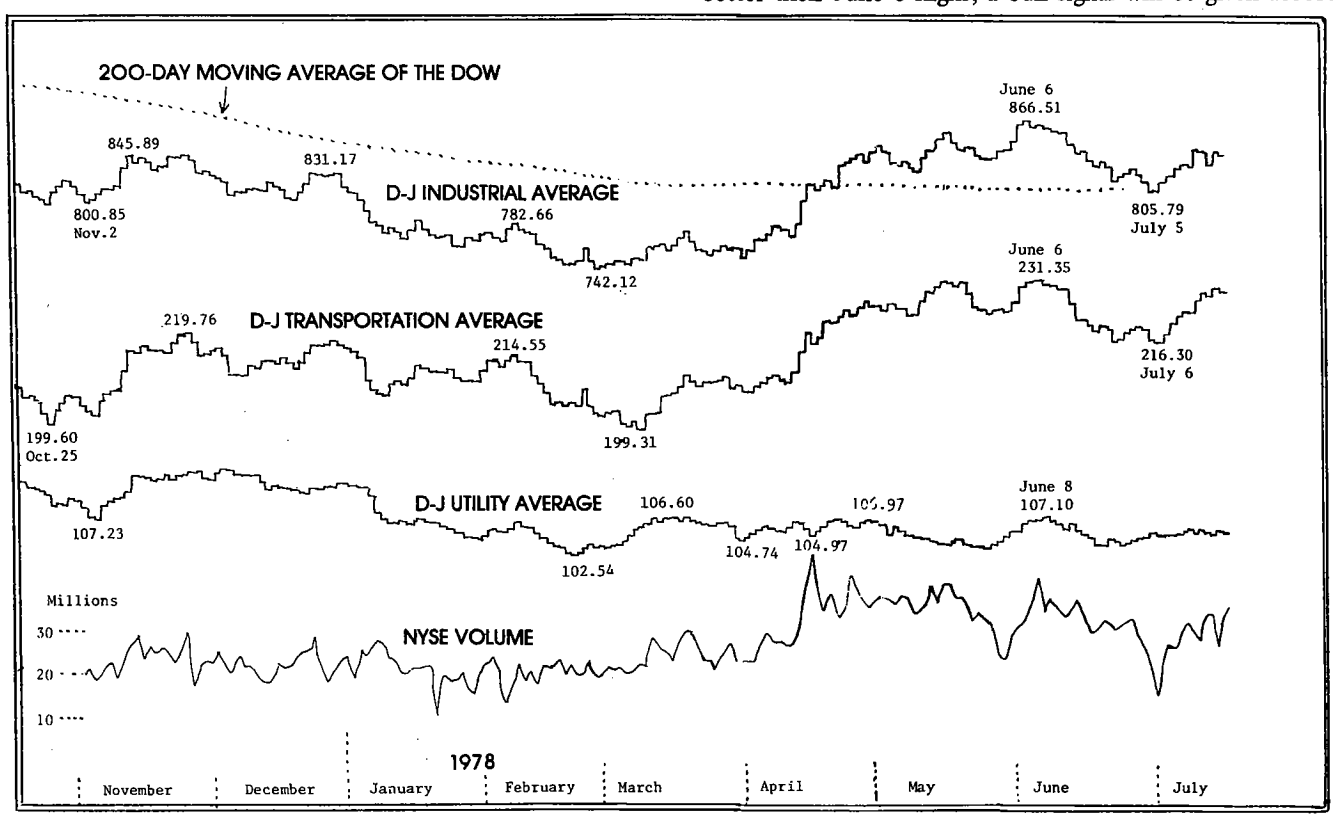
What happens if the Fed just sits by (as it's doing), sits by without boosting stock margins, without raising bank reserves, without really tightening money? For one thing, the dollar would embark on a major new slide to historic lows. This kind of "blind neglect" could cause a panic among foreign dollar-holders who would rush to dump dollars and anything denominated in dollars. Since less foreign commerce is now being transacted in dollars, foreigners have less need for dollars anyway, and the newly jettisoned dollars could flood the money markets. With dollars, bonds, notes and perhaps even US stocks being dumped, market conditions could become chaotic.

It's hard to believe, but it appears as if the Administration and the Fed have decided that they would rather have a runaway money supply, inflation and lower interest rates (if possible) than a strong anti-inflation policy and a strong dollar and a strong nation. After all, the leading economic indicators have turned down and there's an election this fall, and maybe that's all we have to know. At any rate, if the Fed's choice is to "let it be," then we're going to see fireworks between now and the end of the year.

What do we do if the dollar plunges to new lows? My only answer is that we take even larger positions in gold coins, gold bullion and gold futures.

IF... On the week ending June 30 the 13-week moving average of the Dow closed above the 50-week moving average. Thus, a bull signal was given under the moving average study. I warned in previous Letters that, in my opinion, any moving average bull signal would be coming against the prevailing primary trend of the market. Therefore, I was (and still am) very cautious about the June 30 signal. But it did appear; the signal does exist.

On June 6 the D-J Industrials and Transports recorded highs of 866.51 and 231.35 respectively. Following those peaks the Averages declined for a period of approximately one month (see page 1 chart). The decline served to fully correct the rise from the February 28 lows. On June 26 the Averages turned up again, and a rally commenced. If Industrials and Transports can now better their June 6 highs, a bull signal will be given according to



a *mechanical* reading of Dow's Theory. Let me stress, however, that BOTH Averages must better their June 6 highs. A new high by one, unconfirmed by the other, would be a danger signal that could very well mean a top for the market.

The halfway level for the entire 1976-78 decline in the Dow is 878. On the advance from the February 28 lows, the Industrials failed by 12 points to better the 878 peak. The correction from the June 6 highs to the late-June lows followed. If, on any forthcoming advance, the Dow can better the 878 level, it would be a bullish indication.

Question: All right, taking note of all of the above, what do you advocate, Russell?

Answer: It would bother me to say "No" to a good many of my own indicators and studies. But there are a number of things I don't like about this market action, and I might as well list them. (1) I don't like the monetary picture, and I don't like the persistent weakness in the bond markets. (2) I don't like the fact that the Utility Average has gone nowhere since this rally began. (3) I don't like to buy into an advance that did not begin from an over-sold technical condition. (4) I don't like buying into highly speculative markets, where one or two groups (in this case the gambling groups) make headlines. (5) I don't like buying against the four-year cycle, and by that I mean that if this market gets through to 1979 without producing a major (and I mean major) decline and ultimately an over-sold base, it will be the first such occurrence since World War II.

Question: So much for your warning, Russell. But let's say that the market is going to do something radically different. Let's just say the market is about to go into a flight-from-the-dollar type advance. Do you think that such an advance is possible, and if so, what could we do about it?

Answer: Anything is possible on Wall Street. Over a limited period of time the market can do ANYTHING. So let's consider what could conceivably happen. Let's start with the place that Wall Street is watching, and that's the Fed. Wall Street is now scrutinizing Fed Chairman Miller. And the Street notes that Miller's words and his music don't match. The words are conservative, the music is liberal. While talking anti-inflation, the M-1 and M-2 figures are running wild as is the monetary base. So let's postulate that in fear of recession the Fed continues on its present inflationary course. Interest rates level off, even dip a bit, but the money supply grows from a torrent to a river to an ocean.

Let's say that the Carter Administration continues to follow its policy of doing nothing (except talking) while the dollar goes down the drain. Then let's say that the American public begins to panic; they decide that they've got to get out of 10% to 20% of their dollars–and into anything else and that "anything" includes stocks. Let's say that all this occurs, and that a massive flight from currency takes place. Such a phenomenon could conceivably (although I am skeptical) trigger a "blow-off" on Wall Street.

Next question: what would we do about it? If you want to know what I, personally, would do about it, I would skip the move. I've missed dozens, no hundreds, of moves in the market and elsewhere. I've missed moves since the 1940's. I never bought acreage in California, I never bought a 1950 Rolls, I never bought Xerox in 1957, I never bought Resorts International at a buck a share in 1974. I could go on with this list ad finitum, but what I'm trying to say is that I don't mind missing a move (even a big one) if I have my reasons. I might also state that I have never taken a whopping loss; I've never lost 20% or 30% of my capital, and that's rather important to me. I realize that "you can't win 'em all," and that's one of the reasons that I've been around longer than almost any other privately written advisory in the business.

All right, but how about you, my subscribers? How about the subscribers who are willing to look at the odds, recognize the risk/reward ratio, and are still ready and willing to speculate in this market? Is there enough going for this market to justify speculation? My feeling is that IF Industrials and Transports better 866.51 and 231.35 respectively, the upside becomes a fair speculation. IF Industrials then advance decisively above the 878 level, that "fair speculation" becomes a pretty good speculation. It becomes a speculation on this market blowing off on the upside.

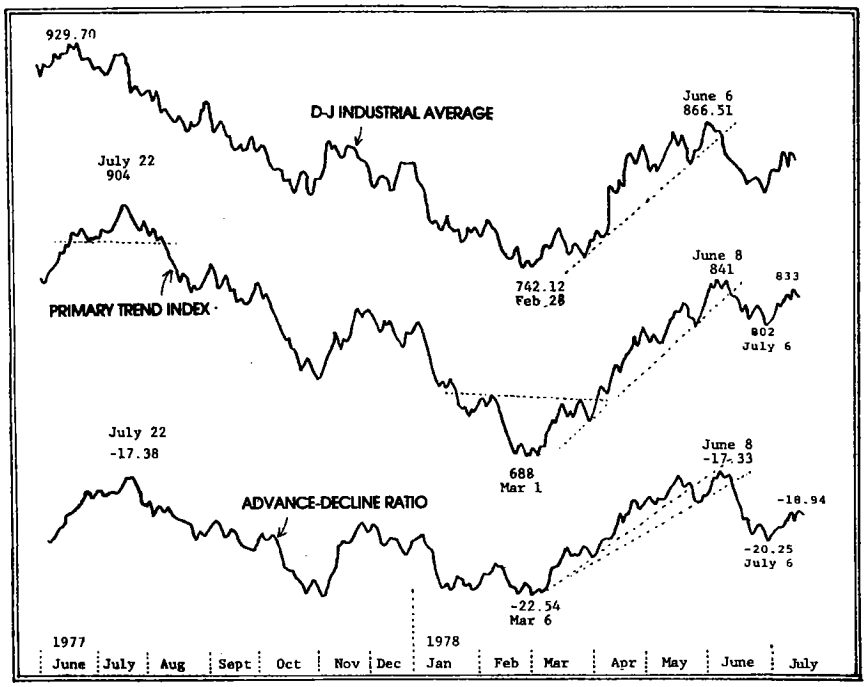
In studying the charts of the entire NYSE over the weekend, I note that most of the Dow-type stocks have behaved unimpressively during the advance since February 28. I also note that many other stocks are on their 5th leg up from the 1974 lows so these stocks are rising "on borrowed time." Nevertheless, if you're going to buy on a joint move of the Averages through their June 6 highs, you've got to have something to buy. The following would be my list. **TWA, Signal Oil, General Dynamics, McGraw Hill, Squibb, Pullman.**

So much for the "possible bull case." I don't think it's going to happen, I really don't. But as I've said so many times, they don't arrange the market for Richard Russell, and I wanted to present the only case I can see for the bulls–a flight from the dollar. But I really think it's too late for that. We're moving too near the next recession (which will probably start in early 1979). I believe the market senses the coming trouble, and I believe that a major market top is now in the process of forming.

PRESENT TECHNICAL PICTURE: The chart on page 3 shows us "where we are" in terms of three of the indicators that I watch closely. The Primary Trend Index (PTI), which is my amalgam of 8 leading indices, topped out on July 22, 1977 at 904. It then dropped back to 688 on March 1. The recovery to June 8 brought the PTI back to 841, still 63 points under the 1977 peak. The PTI has since risen to a July 19 peak of 833. It will be important to see whether the PTI can better its June 8 peak of 841–or whether we've seen the high.

The A–D ratio, which traces advancing or declining tendencies in the majority of NYSE issues, touched a bull market peak on July 22, 1976. It then lost over 5 points, hitting a March 6, 1978 low. On the rally the A-D did better than the PTI, recovering all of its losses and hitting a new high on June 8 which was just 5/100th's above the 1976 peak. Strangely, on the rally since June 8 the A-D's strength seemed to have evaporated. The recovery since the July 6 low has been weak.

Conclusion: The PTI and the A-D Ratio should tell the story from here. New highs would, of course, be bullish for the market while a breaking of the July 6 lows would suggest to me that "we've seen it," that the highs for this whole recovery were recorded on June 6 and June 8 as shown on the chart.



DISCOUNTING: The *major* (primary) movements of the market are always based on the market's DISCOUNTING function. During a bull market, for instance, the entire primary rise is based on the market's gradual recognition and discounting of better times ahead. Since the recognition (and therefore the discounting) is always a slow, tedious process, the bull market only unfolds over an extended period of time. Obviously, if everybody knew it was a bull market, and if everybody foresaw prosperity ahead and acted on that information, the market would double and triple overnight, the discounting would be over in a day and so would the bull market. But bull markets climb a long wall of skepticism and worry, and they therefore take time to develop.

During a bear market, Wall Street attempts to discount and measure the extent of the damage that lies ahead. Since bear markets always follow bull markets, and since people are always rooted in the past (rather than the future), it takes a long time before people can recognize that last year's good times are over and next year's bad times lie ahead. The net result is that a bear market continues to head down, down to the point where there is general recognition and acceptance of the slump and recession (or depression). When everyone knows and has acted on the bad news, then obviously stocks have discounted the worst. And that's where the bear market ends, and the new bull market begins.

Corrections (bull market declines and bear market advances) represent interruptions of the primary movements. Some corrections are based on fundamentals, as for instance, a correction in a bull market which discounts a minor recession. Other corrections are strictly technical, and these are based on psychology, such as an overheated (speculative) bull market tumbling into a secondary decline. Theinterpretation of corrections is one of the most difficult of all market exercises. This is so because corrections tend to look so much like "the real thing" (for instance, a bear market rally can look like the most powerful bull market advance).

When working with the market, there is always the temptation to say, "Ah, I know that this or that is going to happen, and therefore the market must go up or down." And it is possible that your or my "inside information" is the real McCoy–but the better odds are that the market already is well aware of our hot, inside information and that the whole "secret" is already discounted and built into the price structure of the market.

"Exactly right," snaps the market technician, "and that's why we technicians study only the market itself." But, say I, "the technical situation in the market is now rather general knowledge. Whereas ten or twenty years ago, almost no one knew about or cared about odd lots or the short interest or speed lines or confirmations, now everyone is "an expert" on the technical approach, and technical comments and columns are carried in magazines and newspapers across the country.

Then what do we do? How do we approach the market? How can we make decisions? And here all I can provide is my own personal answer. I study all my charts, I keep up with as much data as I can, I read until my eyes are bleary, I think and puzzle, and try to apply both common and uncommon sense. The result is what I put in these reports. I don't know exactly what to call it anymore, except that I happen to call it Richard Russell's Dow Theory Letters. But I will say this. The markets are more difficult now than ever before, because there is more professional competition, more money involved, more institutional research, and there are computers from one end of the country to the other "working" on the great puzzle of Wall Street.

For many months I've been writing about the debt situation, the fact that I believe the total US debt structure has passed the point of no return. I've zeroed in on the debt because I think it's the overriding economic fact of life today, and because I don't believe that the investment community understands the full implications of the debt situation (am I thinking that I know something the market doesn't know?).

But I'm not operating just on the seat of my pants. I know (1) that the bond markets are in shambles, and that there is no worse background for stocks than a sinking bond market. (2) I know that the authoritative *Bank Credit Analyst's* "Monetary Thermometer" is now in the bearish mode, having turned bearish in November, 1977. The Thermometer's record going back to 1916 shows that it has been singularly unprofitable to hold common stocks while the Thermometer has been in the bearish mode. (3) I know that the relationship of bond yields to stock yields is now bearish, with every rally in stocks and every decline in bonds intensifying that bearish relationship. (4) I know that the dollar is hitting new lows against other prominent currencies and that the trade-weighted dollar (measured against 14 currencies) is at a three-year low.

I also reason as follows. The Dow, following its 577.60 low of late-1974 hit a bull market high of 1014.79 on September 21, 1976. The Dow has not been higher since. The advance-decline ratio hit a high on July 22, 1977 and another high (at approximately the same level) on June 8, 1978. It's been four years since the 1974 Dow low, and time is running out on important upside action from here. There has **never been a five-year span** between major market lows (such as 1949, 1953, 1957, 1960, 1962, 1966, 1970, 1974) but if this market makes it into 1979 without a major decline (plus an historic over-sold bottom) it will be the first such instance in modern history.

In other words, the market since 1976 and 1977 has had every chance to discount "a boom" or rosy prosperity or what have you, and it's getting tired. Thus, I believe that the next MAJOR move (forgetting sudden "pops" this way and that) is going to be down. Such a move may not occur until late this year or even until 1979, but the odds say that the next major market movement will be historic and it will go to lower levels.

Operating on that reasoning, I personally don't plan to buy common stocks until this market provides something on the order of a classic over-sold bottom. That bottom has been a long time in coming, but it's going to come. Furthermore, the longer the market holds off on a classic bottom, the more important (i.e., more drastic) such a bottom is apt to be.

Question: Russell, I note that President Carter said on July 12 that there isn't going to be a recession. Suppose he's right. Won't that possibility push the market up?

Answer: No, it's not enough to "not have a recession." The market during 1976 and '77 was discounting the good news and the prosperity, and at 1014.79 the Dow discounted the best, and at the recent A-D peaks of July, '77 and June, '78, the majority of stocks discounted the best. The Utilities have been flat during the '78 advance and bonds have been going down. I believe all the good news and all the "no recession" news has already been discounted by this market.

Where does that leave us now? At this exact moment in time it seems that the market is not terribly impressed by the bull view, and yet the market is not ready to discount the bearish thesis. So that leaves the market in limbo with all the odds favoring the market's NEXT big job being to discount the downside. And I don't care whether economic trouble comes in late-1978, or 1979 or whether it holds off until 1980. The coming trouble will be the next MAJOR event that this market will be discounting.

MUSINGS: Last week I leafed through some of the writings of the late great Dow Theorist, E. George Schaefer. Schaefer was, in my mind, a genius on the primary trend of the market. He seemed to possess a certain "feel," an instinct about the primary trend which put him (and his followers) at a great advantage during the bull market of 1949 to 1966 and during the bear market that began in 1966. I often corresponded with or talked to Schaefer by phone. He offered me many words of wisdom and encouragement, particularly when I was starting out in this business. Schaefer ran two theoretical model portfolios in his advisory service, and when these portfolios racked up astronomical gains during the 1949-66 bull market, Schaefer gained a large following (Schaefer died in September, 1974).

Schaefer did not believe in playing the secondary corrections against the primary bull trend. He would simply use secondaries in a bull market as opportunities to buy more. These additions plus dividends turned his two $50,000 accounts (started in 1949) into two accounts each worth over $1 million by 1955. Schaefer's bear market policy was to sell all common shares and hold only gold and gold shares. During bear markets Schaefer ignored all rallies against the primary trend.

I often wonder what Schaefer would be saying if he were alive today. Would he (as I did) have called 1974 a bear market bottom and the start of a new bull market? Actually, I rather doubt it. I doubt it because he often told me that before the bear market was over he expected to see the Dow below 300, he expected a bond market crash, and he expected very high yields on the Dow. On June 1, 1974 six months before the final Dow low of 577.60, Schaefer wrote, "It's all very confusing because we are still in the second phase of our primary bear market, and this is generally the longest and most deceptive phase of all. . ."

On June 22, 1974 Schaefer wrote, "Right now some people feel that we are in a recession while others feel that they have never been so prosperous. But slowly and surely, times are changing. I feel that we are going to see a lot more inflation before we see a depression. However, I can see a few little cracks in the foundations of inflation. It may be a long time before our superstructure comes down with a crash." On August 31, 1974, a month before he died, Schaefer wrote, "A bond market crash ... eventually will, I believe, be the villain of our present bear market....More dangerous by far than common stocks, which to date, have come down only about one-third in terms of the Dow...and would be off only one-half if the Dow hits 500."

One thing I learned from Schaefer was **patience**. He had infinite patience, and he often wrote that "we have to give the market time to tell its story." Schaefer also knew that with modern Government interference, what used to take a few months to a year to accomplish on Wall Street now takes two or three years or more. Bear movements and bull movements now extend, drag out, and in general take five to ten times as long as they used to. But in the end, the results are usually more drastic (on the upside and the downside) than they were during the early days of Wall Street.

No, I don't know with certainty what Schaefer would say today, but I am guessing that he would say that the 1974 low ended the second phase of the bear market and that the 1974 to 1976 rise was an upward correction or a "pseudo-bull market." I believe that he might say that the third phase started around the 1976-77 highs, but that it would be a long, dragged out, extended affair. Schaefer told me that he thought the bear market would ultimately end in a final plunge that would take the Dow and most stocks to unbelievable lows. He felt that inflation would turn to deflation and that the nation's economy would end in the worst kind of depression. None of that has occurred yet, but of course, we don't know how the story will unwind. Schaefer had an uncanny vision and ability to judge human emotions. Over and over he would state that "fear is the strongest of human emotions", and he noted that just as bull markets end in exuberance and excitement, bear markets end in depression, anger and fear.

I do have a few other thoughts on this. Another market genius, the late Hamilton Boulton (founder of the *Bank Credit Analyst*) wrote on a number of occasions that each spate of prosperity in the US required a great infusion of bank credit. Thus it was taking more and more money to create each additional dollar of GNP. Yet each economic expansion was weaker than the preceding.

At present, with inflation rampant and with borrowing at white hot levels, we see the extraordinary sight of Fed Chairman Miller splitting with his own Board members on whether the discount rate should be raised. Why did Miller do this? I think the reason is that Miller knows that today's "prosperity" cannot take any contraction in the money supply. The spigots **must remain open** or interest rates will go through the roof and the bond market will collapse.

To my mind, the seeds of decades of fiscal insanity are now bearing fruit. Today, financial and monetary stability are a dream, a figment of stabler times. Just as the Government has

been gambling with America's economy, now (with poetic justice) gambling itself has become the new wonder-concept of Wall Street.

I couldn't help thinking of this recent quote from "Pappa" Franz Pick, probably the oldest living inflation fighter. "*Today there is no such thing as investment. The word means to place money for return. But there is no longer any REAL return–only the illusion of return that is created by inflation. Inflation has made 'investment' a pornographic word. Today there is only gambling.*" (Courtesy of Gold & Silver Report, Box 325, Newport, CT 06370).

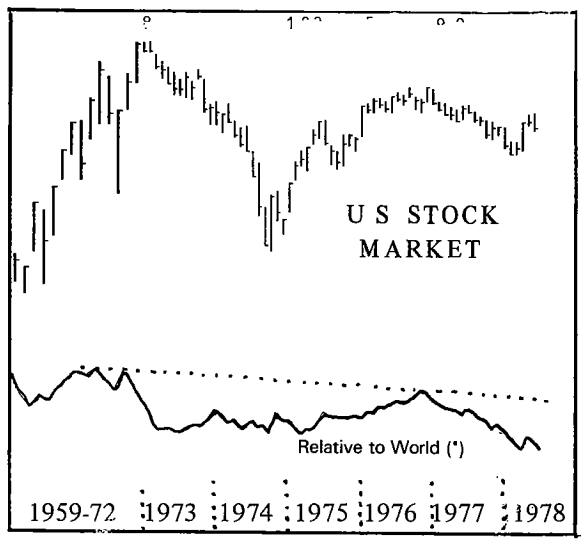
GOLD: I've been talking about gold month after month, urging all my subscribers to take a position in the metal. Over the past two weeks the gold market itself has done the talking, and it's been talking in no uncertain terms. Chart No. 1 shows the daily action of London gold (second fix) and my gold Stock Average (GSA) made up of Campbell Red Lake and ASA. As I've said in previous Letters, it is necessary for these two items to confirm each other.

Since March we have seen a number of downside non-confirmations, and these have all been constructive. But on July 21 we finally received what I have been looking for, and the chart shows this dramatic situation. On that day both gold and the GSA broke strongly out of their patterns to new highs for the year. The force of the breakout was most impressive, and I would now say that gold is in a very bullish phase.

Chart No. 2 is my weekly ratio chart of gold, and this chart shows gold in terms of percentage of rise or fall. Since 1976 gold has risen on a path that has held it well above the lower trendline. Then in early 1977 gold held above a higher (but not steeper) trendline. All of this was, of course, bullish. This chart also shows my Elliott Wave count. Wave 1 contained 5 waves, and ended in late-1976. Wave 2 corrected wave 1, taking gold from 153 back to 140. By my Elliott count gold is now in wave 3, and this wave should divide into smaller a,b,c,d,e waves. The a through d waves are now completed and gold is currently in wave e. The e wave should wind up major wave 3. It should also be the strongest and most speculative sub-wave in larger wave 3. Following a wave 4 correction, gold should embark on bullish wave 5. That wave should be something to see.

Chart No. 3 shows the giant "head-and-shoulders" formation in gold, a formation I have been directing readers' attention to for many months. The upside breakout from this formation will come at a price of about 196, but to be safe I would rather say that a second fix above 198 would constitute the breakout. If this occurs, gold should fulfill the chart count by ultimately moving near or above the 285 level. But it will take time. I note that most of the older gold bulls and so-called "gold bugs" are much more conservative now than they used to be. Where they used to predict "500 or more" for gold, they now suggest "maybe 215 or 219" for gold. Just as the old gold-bugs were too optimistic in 1973 and 1974, I think they are currently too conservative on gold. After all, the US Government is spending roughly a billion dollars a day, and that budget threatens to go higher. With that amount of paper being run off the presses, who is to say where real money (gold) can go!

Chart No. 4 shows gold, its 4-week moving average (MA), its 13-week MA, and its 50-week MA. Note that gold has really not advanced very far above either its 13-week MA or its long-term or 50-week MA. The distance from the MA's allows us to judge when a move has gone "too far and too fast." I would say that the current breakout and rise in gold could go considerably further before running into corrective pressures. Of course pull-backs and sideways movements give the MA's time to rise, and such action renews and extends any advance. So don't be impatient; let's let gold tell its own story in its own way. George Schaefer used to say that "There's no fever like gold fever." As I see it, the fever hasn't even started–yet.



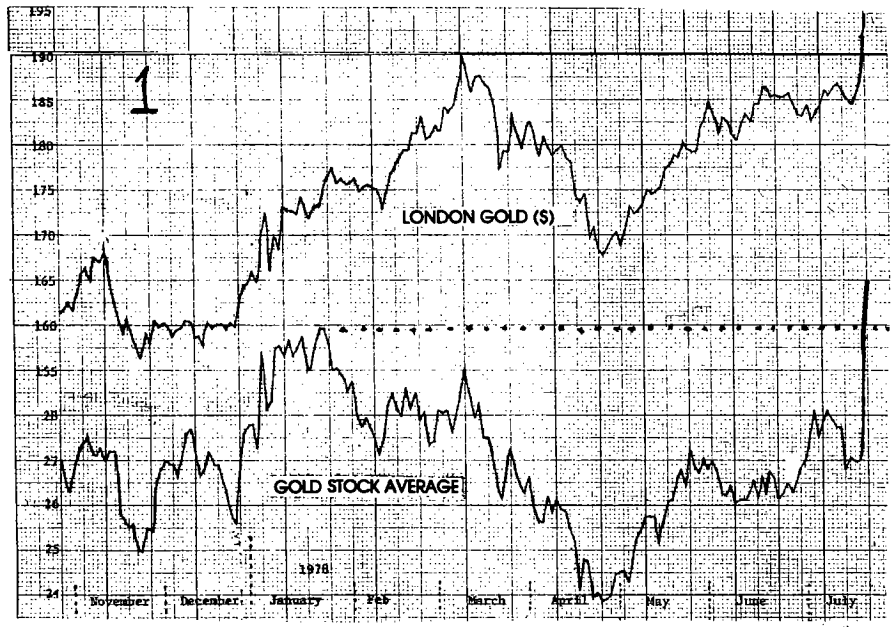
Conclusion: This chart is put out by *Capital International Perspectives*, Geneva, Switzerland. It shows the US Stock Index but more important, it shows the US Index's relative strength against the World Index of 17 leading Free Nation stock indices. On a relative basis, the US Index is going down to new lows. I find this a most ominous picture. With a national debt approaching $800 billion, with a spending program of $1 billion a day, with annual deficits above $50 billion, the US is spending itself into poverty. The thermometer of this sickness is gold and the dollar. Gold is moving up as the dollar declines.

With the dollar's value being revised downward almost daily in international markets, it is most important that all subscribers keep a certain portion of their assets in real money. Gold is the only real money available. Many months ago I suggested 10% to 15% in gold. More recently I raised this figure to 15% to 20% of assets in gold. I would now suggest 20% to 25% of assets in gold. Most of the rest may be kept in liquid form, and that means T-bills or cash or the equivalent.

NOTES & QUOTES: The world is moving away from the dollar. The impetus is fear of the US printing press. But a huge percentage of the US debt is held by foreigners. If foreign interests begin to pull out of US paper, the Fed will be faced with a fearful dilemma. But they will have to **act**, and the action will have to take the form of higher interest rates (the higher rates will be the Fed's way of seeking to attract new buyers). Such action should send the bond market to lower levels, perhaps dramatically lower levels.

Atlantic City may be new to the gambling business, but the US Government has been gambling for a long time. They've been gambling on the idea that foreign holders of dollars would sit on their hands while their investments in US dollars went down the drain. The US is going to lose that gamble. And as I've said before, the longer the US plays that game, the worse the ultimate

conclusion. I believe that we've reached about the peril point with foreigners. In Carter, in Fed Chairman Miller (who recently predicted "lower interest rates"!), in the US Congress, foreign dollar-holders see no hope. When the politicians won't move, the market moves for them. We have been seeing the bond markets move down all year and the stock market move sideways ever since mid-1977. But the movements have, so far, been rather polite. Let's see how long the "politeness" lasts–as the dollar sinks to new lows, month after month.



Requests: I appreciate all the letters that come here each day. I have to write very short answers to each, so don't take offense at my brevity. Please, do not write about Carter and the Tri-lateral conspiracy. I have been flooded by Tri-lateral literature. If there is a conspiracy and Carter is an integral part of it, he'll probably bungle the whole thing, so don't worry much about it. Someone recently described Carter as sincere, intelligent, articulate, aggressive, tireless and totally incompetent.

Of interest: Government regulations say that any jewelry which contains 40% or more of gold (10 carat) can be called "gold." Pure gold would be 24 carats. Thus, it is most important when buying "gold jewelry" to ask for the carat content. It could be as low as 40% in gold and still be termed gold.

NEXT MAILING: August 9